# Memorandum

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| Subject Interview with [redacted] | Date May 9, 1996 |
| | ~~60-2096-0002~~ |

To Frito-Lay File

From Nina Hale NH

b7D

On today's date, Jill Ptacek and I interviewed [redacted]

distribution: RWF, DNK, HALE, PTACEK, ALEXANDER - EAG, SWEENEY, JONES, CASE, CHRON, ARCHIVE

Geographic Market

b4, 7D

[redacted]

Capacity

[redacted]

Products

[redacted]

According to [redacted] we ought to be looking at different submarkets than simply the snack food industry. In their view, consumers go into a store with tortilla chips on their list, not salty snacks.

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Therefore, we ought to be looking at relevant markets that consist only of potato chips or only of corn chips and tortilla chips, or only of popcorn, or only of pretzels.

Market Share

[redacted]

Business Mix

[redacted].

Distribution

[redacted] uses independent distributors for the most part. These distributors take title to the product and are responsible for stocking the shelves of the various retail outlets in which the product is sold. Ten percent of [redacted] distributors are company-owned. Depending on the geography, account, and distributor, the majority of [redacted] accounts have relationships with [redacted]

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Exempt under b7D

[redacted]

7D

Competitors

[redacted]

[redacted]

[redacted]

Product Promotion

We wanted the interviewees to address the issue of product promotion. In answering our question, it appeared useful from the standpoint of the [redacted] representatives that they give us a history of the industry. Therefore, they went back to approximately 1987/1988 when the cola wars were taking place. The cola wars were a series of marketing efforts by Coke and Pepsi which resulted in a price war for the shelf space in supermarkets. As a consequence, supermarkets began to think that they could extract fees from manufacturers for shelf space outside of the Coke and Pepsi realm. Then, in the late 1980's, Eagle Foods came in and began buying shelf space as a way of acquiring market share. Once Eagle started paying for shelf space, Frito-Lay started matching or beating Eagle's offers. Retailers began to realize how much more profitable the snack food business could be if they charge for shelf space on top of the margin that they were getting for the product itself.

Bad Acts

According to the people from [redacted] Frito-Lay's approach to the snack food business is as follows: "Our business is up and we need more space, therefore we will give you (retailer) $1,000 a foot plus the following promotions." Because of its strong market share, Frito-Lay knows that one foot of space for its products will generate at least $12,000 in gross sales. And even if the retailer is not willing to sell the space to Frito-Lay, this retailer now has a sense of what the space is worth for purposes of negotiating/extracting fees from Frito's competitors. Eagle [redacted] will only generate [redacted] worth of sales for the same foot of space because Frito-Lay's consumer franchise is so large. For Frito-Lay, $1,000 for space is 7 percent of its sales. [redacted] Frito's pitch is profitable for the retailer and they are very likely to accept the offer. According to [redacted] once Frito gets 80 percent of the space, then the payments stop and the prices to consumers go up. The people from [redacted] encouraged us to look at the situation in Texas and in California. Their view is that we will find that retailers are unable to extract space fees, or at least the fees are much lower and the promotions are much less significant, if in existence at all. Before the cola wars of the late 80s, space in a retail outlet was based upon market share only. However, by aggressively promoting

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potato chips, Frito-Lay has taken all the profit out of the business and it has been subsidizing its potato chip business with monopoly profits from the tortilla chips and the corn chips. 7D

We asked [redacted] why Frito-Lay would take this position with the potato chip market. They answered that Frito-Lay knows that Eagle, [redacted] and the others are basically potato chip companies. Their sales are coming primarily from potato chips. If Frito-Lay prices its potato chips below cost, then it could drive the competitors out and raise prices across the board.

1) Grocery Stores

We tried to get a sense from [redacted] as to how much Frito-Lay is paying for space in retail outlets or how much retail outlets are seeking to extract. Their suggestion was to ask the retailers to describe the program that Frito offers. They say that these programs are called "CMA," which stands for consumer merchandising agreement. These CMAs can include any number of features that Frito would ask for in exchange for an upfront payment and help with certain promotions. For example, in one instance, Frito might say "we want four more feet of space in exchange for which we will give you an upfront payment, an automatic bill back of everything that you sell above certain quota, guaranteed buy one get one free promotion, a pot of money to promote the product, and a certain number of end caps (which are also referred to as EAMs meaning end aisle merchandising, which is the most valuable space in the store), single serve racks, exclusive spots at the check-out stand, and bread tables."

[redacted] claims that it cannot afford to match these kinds of payments and promotional payment packages which are required to get into and grow in the grocery business. Fortunately, the "up and down the street stores" do not require these kinds of packages. On the other hand [redacted] realizes that in order to survive, it has to be in the grocery business where it would not have a presence and it wouldn't do any good that the up and down the street stores do not charge or demand payments that the grocery stores do. So, what [redacted] does is negotiate with the grocery retailers for pieces of the same package that Frito offers to the retailer as a package.

We asked about the category managers. The category manager, according to [redacted] is a person who is schooled or trained in a particular category of food in a grocery store. They either advise or supervise the buyers of product. They too had heard that some of these category managers are employed by Frito-Lay and conceded that to their knowledge the presence of Frito-Lay employees was not inherently bad. Indeed, if they had the money, they would be happy to put someone in the store because they could see the advantage, but they did feel that it was something that came with high market share which Frito definitely has.

Club Stores

We asked [redacted] about other programs that Frito has with retail outlets. They described for us the growth programs and have described these as fairly successful. For example, a number of years ago, Frito introduced a program to get into the club store business, which includes such retail outlets as Wal-Mart and Sam's Club. Apparently, what Frito-Lay did was offer a pre-established discount that has been maintained for the last two or three years, where a consumer can get two bags for $3. Elsewhere today, those bags are priced at considerably more than $1.50 a piece.

Convenience Stores

We also wanted to hear from [redacted] about what convenience stores they had been forced to exit or to cut back because apparently Frito has a very strong program going to get exclusivity in the convenience stores. According to [redacted] Frito goes to the convenience store and says "we can improve your profits and simplify your life if we can be your exclusive supplier, and we will pay you for that privilege." As a consequence of this program, [redacted] lost access to [redacted] could have offered to pay for exclusivity, but Frito-Lay's strength with consumers is so much greater that even if [redacted] payment were equal, the convenience store would still go with Frito-Lay. [redacted] has not gone back to the [redacted] that it was kicked out of because it does not have the resources. Apparently, the convenience store trade is not very profitable for the distributor, so [redacted] using as it does independent distributors, has a difficult time convincing them to service the convenience stores as compared to the grocery stores where an hour's worth of work can generate [redacted] worth of sales as compared to [redacted] in a convenience store.

7D

We asked whether the [redacted] people could think of any advantages for the convenience that would come with exclusivity to one snack food supplier. Although they did not expand on this, they thought that convenience stores which is thinly staffed might prefer having only one truck stop to deliver, service the product and only one invoice to deal with.

Finally, we got one anecdotal piece of evidence regarding a convenience store where [redacted] is currently fighting to stay in and is therefore unwilling to give us the name. [redacted]

[redacted]

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[redacted]

Up and Down the Street Stores

We asked whether they had ever heard the phrase "UDS." Their response was that it might refer to the up and down the street stores. [redacted] b5

[redacted] According to [redacted] it makes more gross profit (which b7D means revenue, less manufacturing cost before the marketing expenses) per pound in grocery stores, but the trade discounts knock the gross profit down, as compared to the UDS stores, where the gross profits are lower, but there are no trade discounts. That means that while the UDS stores are more time consuming to service, the profits overall are higher.

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Exempt under b5, b7D